

**UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEW MEXICO**

**In re:**

**FURR'S SUPERMARKETS, INC.,  
Tax I.D. No. 22-3137244,**

**Debtor.**

**Case No. 11-01-10779-SA**

**UNITED STATES TRUSTEE'S BRIEF IN SUPPORT OF OBJECTION TO  
APPLICATION FOR EMPLOYMENT OF CHANIN CAPITAL PARTNERS, LLC**

The United States Trustee for the District of New Mexico hereby submits the following brief in opposition to the Application for Order Authorizing Employment of Chanin Capital Partners, LLC (Application) filed by the Unsecured Creditors Committee (UCC). The thrust of the U.S. Trustee's objections relate to (1) the attempt to employ Chanin Capital Partners, LLC (Chanin) pursuant to 11 U.S.C. §328(a) and thereby approve compensation without compliance with 11 U.S.C. §330 and (2) various provisions in the retention agreement which conflict with the express provisions of the Bankruptcy Code and its underlying policies, particularly with regard to the indemnity provisions. Because the indemnity provisions are particularly contrary to the status and responsibilities of bankruptcy professionals, the objections to that provision will be treated separately.

**I. Relevant provisions of the Application to employ Chanin Capital Partners, LLC**

As set forth in the Application, the UCC seeks to retain Chanin pursuant to the terms of a letter agreement, which is attached to the employment application. (The "Letter Agreement").

The Letter Agreement was revised on June 7, 2001.

1. The Application requests authorization for employment under 11 U.S.C. §328 (a) which would fix the terms of compensation absent a subsequent showing that they were improvidently approved, “in light of developments not capable of being anticipated...” In these circumstances, Chanin’s employment under this provision of the statute is unwarranted.

2. The Application does not establish the reasonableness of the fees requested therein, and all fees requested by Chanin should be subject to approval by the Court pursuant to the reasonableness requirements of 11 U.S.C. §§330 & 331.

a. The Application provides for a “restructuring transaction fee” of one percent (1%) of enterprise value for any sale in excess of \$160,000,000. This is apparently without regard to Chanin’s role or contribution to such an outcome.

b. The Application further does not specify how the \$160,000,000 is to be computed.

c. The Application provides for a monthly fee of \$100,000 with no specification as to the work to be performed by Chanin on a monthly basis.

3. The Application includes services to be rendered by Chanin which appear to be duplicative of services rendered by Deloitte & Touche. Further, the services also appear to be duplicative of those proposed for the Debtor’s investment banker, Peter J. Solomon Co., Ltd.

4. Although the affidavit of Randall L. Lambert indicates that Chanin has no current connections with the Debtor and any significant parties in interest and their professionals, the Affidavit states that Chanin may in the future represent creditors and other parties in interests. See Affidavit of Randall L. Lambert at ¶s 5, 6, & 7. However, the Application fails to state whether Chanin will periodically review its connections to supplement its disclosures.

5. The Letter Agreement attached to the Application provides that the Debtor will reimburse Chanin for out-of-pocket expenses. See Letter Agreement at ¶3 (c). To the extent that this provision authorizes Chanin to retain legal counsel and obtain payment therefor without Court authorization and approval, objection is made thereto.

6. The Debtor may not terminate the agreement with Chanin within the first three months of Chanin's employment, unless there is a closing of a sale of substantially all of the Debtor's assets prior to that time. Such provisions should be subject to the issuance of a Court order terminating Chanin's employment. Further, the amount of any fees due upon termination should be subject to Court approval, after notice and hearing.

7. The Amended Letter Agreement provides that it shall be governed by the "laws of the State of New York" and requires arbitration of any disputes. See Letter Agreement at ¶8. To the extent that this conflicts with the provisions of federal bankruptcy law and impinges on Bankruptcy Court jurisdiction, objection is made thereto.

8. The indemnification provisions of the letter agreement are over broad, premature, unreasonable, and inconsistent with an investment banker's responsibilities to act as a fiduciary for the estate and creditors thereof. The United States Trustee believes that the indemnification agreement that Chanin seeks is entirely inappropriate.

9. No disclosure is made with regard to the number and qualifications of Chanin personnel to be devoted to this employment, together with specific tasks to be performed by them during the expected duration of the employment. Neither is any disclosure made with regard to any other resources necessary for Chanin to perform under this retention agreement.

10. At no point is disclosure made as to the hourly billing rates of the Chanin professionals.

**II. Chanin Capital Partners, LLC has not demonstrated the reasonableness of the compensation which it has requested and Chanin should be subject to the requirements of 11 U.S.C. §330.**

“The burden of proof to establish that proposed terms and conditions of employment are reasonable is on the moving party. The Court must be persuaded that the terms and conditions are in the interest of the estate.” *In re Gillett Holdings, Inc.* 137 B.R. 452, 455 (Bankr. D. Colo.1991), citing *In re C & P Auto Transport, Inc.* 94 B.R. 682,686 (Bankr. E. D. Cal.1988). The UCC therefore bears the burden of proving that the terms and conditions of the proposed retention of Chanin are reasonable.

Further, at least one court has held that employment applications by an investment banker/adviser:

[M]ust present the scope and complexity of the assignment, its anticipated duration, expected results, required resources, the extent to which highly specialized skills may be needed and the extent to which they have them or may have to obtain them, projected salaries of participating professionals, billing rates and prevailing fees for comparable engagements, current retentions in bankruptcy by the retained firm, and any estimated lost opportunity costs due to time exigencies of the job.

*In re Drexel Burnham Lambert Group, Inc.* 133 B.R. 13 (Bankr.S.D.N.Y.1991).

In this case, none of the above factors have been addressed by Chanin in its employment application. Chanin seeks to have its entire retention agreement, which includes the compensation structure and the indemnification provisions approved, and therefore subject to review only, if it can be proven that such provisions are improvident in light of developments not capable of being anticipated at the time of the fixing of such terms...” 11 U.S.C. §328 (a).

As stated by the court in *Drexel*:

All investment bankers/advisers want sizable monthly retainers regardless of the size of the case, the party represented, or the complexity of the case. Mathematically a correlation of fees, cases, and clients shows at worst, incestuous fee setting practices or, at best, oligopolistic behavior. From our experience in this case, and others, it is clear that the investment banking community starts with the retainer and works backward, using a variety of non-bankruptcy criteria to defend the fee charged. Whenever we have dealt with investment bankers and financial advisers we have been left with a strong impression that for them the debtor is a cash cow to be milked, Chapter 11 the milking parlor, and the Judge the milking stool. 133 B.R. at 26.

When faced with an argument by two investment bankers that they should not be required to submit fee applications, one Bankruptcy Court in the Tenth Circuit stated as follows:

This Court is persuaded that Smith Barney and DLJ must file legally sufficient applications for fees in the same manner and subject to the same basic statutory requirements as other professionals. As a general rule, investment bankers must be treated as other Section 327 professionals and should not be given extraordinary treatment absent a compelling reason to do so. *In re Gillett Holdings, Inc.* 137 B.R. 452, 457 (Bankr.D.Colo.1991).

Another court, facing the same issue stated as follows:

This Court is unable to find any authority supporting the proposition that investment advisers are not subject to the mandate of Bankruptcy Rule 2016(a), which requires that an entity seeking compensation shall file an application setting forth a detailed statement of services rendered, time expended, and expenses incurred. While this Rule may not please the community of investment advisers, this Court is constrained to conclude that the Bankruptcy Rules are controlling, not the general policy or custom of the investment advisers which prevails in the operation of the business of investment bankers or advisers. *In re Hillsborough Holdings Corp.* 125 B.R. 837, 840 (Bankr.M.D.Fla.1991).

In addition to the highly suspect proposition that Chanin should be exempt from the requirements of §330, is the plain fact that it is virtually impossible to reach an informed judgment on the reasonableness of fees requested until such time as the services have been rendered. The Bankruptcy Code itself states that in determining reasonable compensation all

relevant factors should be taken into consideration including (1) the time spent, (2) the rates charged, (3) whether the services were necessary or beneficial to the estate, (4) whether the services were performed within a reasonable time, and (5) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases outside of bankruptcy. 11 U.S.C. §330(a)(3).

Although Chanin may argue that it receives this fee structure in non-bankruptcy cases, market rates charged outside of bankruptcy are but one factor in determining reasonableness. Several courts have sustained this position. *In re Hillsborough Holdings Corp.*, supra (investment banker fee application denied due to lack of time records and evidence of benefit to the state); *In re Gillett Holdings, Inc.* supra (employment applications of two investment bankers requesting \$175,000 per month denied, in part due to lack of justification for fees); *In re NBI, Inc.* 129 B.R. 212 (Bankr.D.Colo.1991) (reasonableness of professional fees evaluated on several factors including, within appropriate limits, cost of comparable non-bankruptcy services); *In re Zolfo*, 50 F.3d 253 (3<sup>rd</sup> Cir. 1995) (accounting firm failed to carry its burden of showing that its customary fees were warranted in Chapter 11 proceeding).

Given that a professional's customary fees are but one factor in determining reasonableness of compensation, no judgment can be reached at this time on that issue. That must await the submission of a fee application which demonstrates the nature, extent, and value of services which Chanin renders in this case.

### **III. Certain provisions of the Chanin Application should be invalidated as violative of fiduciary duty and impinging on the authority of the Court.**

The debtor-in-possession is a fiduciary. *Commodity Futures Trading Commission v. Weintraub* 471 U.S. 343,355, 105 S.Ct. 1986, 1994, 85 L.Ed.2d 372 (1985). Likewise, Chapter

11 creditors' committees and their members are fiduciaries. *Woods v. National Bank & Trust Company*, 312 U.S. 262, 268, 61 S.Ct.493, 497 (1941); *United Steelworkers of America v Lampl* (*In re Mesta Machine Co.*), 67 B.R. 151 (Bankr.W.D.Pa.1986). Investment bankers, as estate professionals, are likewise fiduciaries. *In re Allegheny International Inc.* 100 B.R. 244, 246 (Bankr.W.D.Pa.1989)(specifically involving investment bankers for creditors' committees) *In re Gillett Holdings Inc.* 137 B.R. at 458. As such, investment bankers have an obligation of fidelity, undivided loyalty and impartial service in the interest of creditors. *In re Allegheny International, Inc.*, supra.

In addition to the above, it has been held:

Freedom of contract is necessarily limited in the bankruptcy context. Bankruptcy counsel and debtors are not at liberty to bargain away the rights and responsibilities of a debtor-in-possession, nor the protection afforded creditors and other parties in interest in a bankruptcy case, under the guise of freedom of contract. They cannot evade the jurisdiction of the Court by choice, nor limit exercise of the Court's discretion by fiat.

*In re NBI, Inc.*, 129 B.R. 212 (Bankr.D.Colo.1991). Despite this, the terms of the Letter Agreement appear to evade the Court's jurisdiction and/or limit the Court's discretion.

Based on the above, it is the position of the United States Trustee that Chanin be retained only if it complies with the provisions of the Bankruptcy Code and Rules by providing the detailed information requested above, and by filing detailed time records and fee applications subject to review of the parties and a determination of reasonableness by the Court pursuant to 11 U.S.C. § 330. Further, the provision stating that the retention of Chanin is to be governed by the laws of New York should be modified to yield to the primacy of federal bankruptcy law. Chanin has provided no convincing authority for its position that its Letter Agreement should be approved pursuant to 11 U.S.C. § 328(a).

**IV. Indemnification provisions are overbroad, overreaching and contrary to a bankruptcy professional's fiduciary responsibilities.**

**A. Summary of Argument**

Contractual arrangements holding persons harmless for the damages caused by their negligence are disfavored in the law. Two aspects of the financial advisory services provided by Chanin should render its request for indemnification unacceptable here: the professional nature of the services called for and the setting where those services were to be performed. Each of these considerations provides a basis for invalidating the Indemnification Provisions entirely.

1. Chanin has offered to supply professional services to the UCC, i.e., it has proposed to perform tasks that require a high degree of skill and care, based upon special learning and advanced knowledge. Indemnification requests tendered by professionals are looked upon with special, heightened disfavor. Financial advisors should be held to high standards of care analogous to those applicable to lawyers and underwriters; their high calling precludes any request to be held harmless for their negligence. *Erlich v. First Nat'l Bank of Princeton*, 208 N.J. Super. 264, 288, 505 A.2d 220, 233 (N.J. Super. L. 1984). "Indemnification is not consistent with professionalism." *In re Mortgage & Realty Trust*, 123 B.R. 626, 631 (Bankr. C.D. Cal. 1991). See, also, *Eichenholtz v. Brennan*, 52 F.3d 478, 484-86 (3d Cir. 1995); *In re Allegheny International*, 100 B.R. at 246 .

2. Indemnification of professional negligence, even if it were palatable elsewhere, is wholly inappropriate for the governance of conduct in the provision of professional services in a Chapter 11 bankruptcy proceeding. In this highly regulated context, the professional providing

services has the special legal obligations of a fiduciary both to the committee and its constituency. An attempt to indemnify a person for negligence in advance, without any possible way of ascertaining what harm might be done, is inconsistent with the duties of the UCC to its constituents. *In re Mortgage & Realty Trust*, 123 B.R. at 631. *See also CFTC v. Weintraub*, 471 U.S. 343, 355 (1985); *Official Comm. of Unsecured Creditors of United Healthcare Sys., Inc. v. United Healthcare Sys., Inc. (In re United Healthcare Sys., Inc.)*, 200 F.3d 170, 177 n.9 (3d Cir. 1999), *cert. denied*, 530 U.S. 1204 (2000). What might be an acceptable arrangement in the ordinary commercial environment is frequently forbidden in such a fiduciary context. *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, C. J.).

**B. The Conditions of Employment Submitted to the Court For Approval Are Not Presumptively Reasonable.**

Prior to the instant litigation, in several published decisions, the courts have rejected indemnification arrangements for financial advisors. *See, In re Allegheny Int'l, Inc.*, 100 B.R. at 247 (“holding a fiduciary harmless for its own negligence is shockingly inconsistent” with standard of care required); *In re Mortgage & Realty Trust*, 123 B.R. 626, 631 (Bankr. C.D. Cal. 1991) (“[i]ndemnification is not consistent with professionalism”); *In re Drexel Burnham Lambert Group*, 133 B.R. at 27 (“[s]imply stated, indemnification agreements are inappropriate); *In re Gillett Holdings, Inc.*, 137 B.R. 452, 458 (Bankr. D. Colo. 1991) (“entirely improper and unacceptable”).<sup>1</sup>

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<sup>1</sup> But, see, *In re Joan and David Halpern Inc.*, 248 B.R. 43 (S.D. N.Y. Bankr. 2000), *aff'd*, S.D. N.Y. No. Civ. 00-3601 (Dec. 6, 2000) (2000 WL 1800690).

Approval of professional service contracts under sections 1103 and 328 is a serious process. The application must thoroughly disclose all of the terms of employment. Fed. R. Bankr. Pro. 2014(a). *Id.* See, also, *Land v. First Nat'l Bank of Alamosa (In re Land)*, 943 F.2d 1265, 1266-67 (10<sup>th</sup> Cir. 1991) (summarizing the scrutiny of professional service payments). The applicant must affirmatively establish the professional's qualifications, *In re Interwest Business Equipment, Inc.*, 23 F.3d 311, 318 (10th Cir.1994), and bears the burden of proving that the terms and conditions of retention are reasonable, *Zolfo, Cooper & Co. v. Sunbeam-Oster Co., Inc.*, 50 F.3d 253, 259 n. 5 (3d Cir. 1995). An active judicial scrutiny of the proposed retention agreement is required, inasmuch as any order by the “court to compensate the approved professional [will come] from the funds of the bankrupt debtor.” *Baehr v. Touche Ross & Co. (In re Philadelphia Mortgage Trust)*, 930 F.2d 306, 309 (3d Cir. 1991). Under the Bankruptcy System, both the creditors and the United States Trustee<sup>2</sup> may question employment applications. But, even in the absence of objections, the courts have an independent duty to review employment requests.<sup>3</sup> A term or condition of employment is not “reasonable,” for

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<sup>2</sup> United States Trustees are officials of the Department of Justice appointed by the Attorney General to supervise the administration of bankruptcy cases and trustees. See, 28 U.S.C. §§ 581-589 (specifying the powers of United States Trustees); *United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Syst., Inc.)*, 33 F.3d 294, 296 (3d Cir. 1994) (United States Trustees oversee the bankruptcy process, protect the public interest, and ensure that bankruptcy cases are conducted according to law)(citing H.R. Rep. No. 95-595, 109 (1977)); *United States Trustee v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6<sup>th</sup> Cir. 1990) (“[t]he United States trustee, an officer of the Executive Branch, represents \*\*\* [the] public interest”).

<sup>3</sup> *Cf., Matter of Kirkpatrick & Lockhart (In re Busy Beaver Building Centers, Inc.)*, 19 F.3d 833, 841 (3d Cir. 1994) (the “bankruptcy court has a duty to review fee applications, notwithstanding the absence of objections by the United States Trustee, creditors, or any other interested party, a duty \*\*\* which \*\*\* derives from the court's inherent obligation to monitor the debtor's estate and to serve the public interest.”); *In re Interwest Business Equipment, Inc.*, supra,

purposes of § 328, simply because the parties agreed to it, or because it is not illegal under State law outside of the bankruptcy context. See *NBI, Inc.* supra.

**C. Indemnification Provisions Are Inherently Inconsistent With The Professional Role of The Financial Advisors.**

"Exculpatory contracts are not favored by the law because they tend to allow conduct below the acceptable standard of care." *Yauger v. Skiing Enterprises, Inc.*, 206 Wis.2d 76, 81, 557 N.W.2d 60, 62 (1996). See, also, e.g., *A to Z Applique Die Cutting, Inc. v. 319 McKibbin St. Corp.*, 232 A.D.2d 512, 649 N.Y.S.2d 26 (N.Y. A.D. 1996) (lease provision shielding landlord negligence void as against public policy); *Borg-Warner Ins. Fin. Corp. v. Executive Park Ventures*, 198 Ga.App. 70, 400 S.E.2d 340 (Ga. App. 1990) (lease provision shielding tenant negligence void as against public policy).

\*\*\* It is not the rule that any agreement by any person which assumes to place another person at the mercy of his own faulty conduct is void as against public policy. \*\*\*  
However, the law does not look with favor on provisions which relieve one from liability for his own fault or wrong \*\*\*.

17 Am. Jur. 2d, Contracts § 297 & n.72 (1991).

Where professional services are at issue, the arrangement cannot be regarded as a purely commercial one. A "profession" is a "vocation or occupation requiring special, usually advanced, education, knowledge, and skill; e.g. law or medical professions." Black's Law Dictionary 1089 (5th ed. 1979). A professional person is charged with exercising a special degree of care in the discharge of his or her work, reflecting that special attainment.<sup>4</sup> For

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23 F.3d at 316.

<sup>4</sup> See, e.g., *Johnson v. State*, 37 S.W. 3d 191 (Ark. S. Ct. 2001) (policemen); *Dayton Bar Ass'n v. Baker*, 711 N.E.2d 661 (S.Ct. Ohio) (*per curiam*) (lawyers); *Jerry Clark Equipment*,

anticipated professional conduct, a higher calling, requests to be excused the consequences of negligence are viewed as unseemly. “It is tacky, to say the least, for a professional to hide behind such a clause.” *In re Healthco Int'l., Inc.*, 195 B.R. 971, 987 (Bankr. D. Mass. 1996) (financial advisory services).<sup>5</sup>

In the legal profession, it has long been accepted that it is inappropriate for a professional to accept any form of indemnification from its client. The profession’s rules of ethics prohibit attorneys from accepting indemnity in connection with professional services. Model Code of Professional Responsibility DR 6-102; Model Rules of Professional Conduct Rule 1.8(h); *see also In re Mortgage & Realty Trust*, 123 B.R. 626, 630 (Bankr. C.D. Cal. 1991) (“ethics rules prohibit an attorney from obtaining an indemnity from a client in connection with professional services”). Under the Model Code of Professional Responsibility DR 6-102, a lawyer is prohibited from even attempting “to exonerate himself from or limit his liability to his client for his personal malpractice.” *See, also, e.g., Porubiansky v. Emory Univ.*, 156 Ga. App. 602, 275 S.E.2d 163 (Ga.App. 1980), *aff’d sub nom. Emory University v. Porubiansky*, 248 Ga. 391, 282 S.E. 2d 903 (S. Ct. Ga. 1981) (dentists). *Cf., Valhal Corp. v. Sullivan Assocs., Inc.*, 44 F.3d 195, 202-04 (3d Cir. 1995).<sup>6</sup>

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*Inc. v. Hibbits*, 612 N.E. 2d 858, 863 (Ill. App. 5th Dist. 1993) (accountants); *French Drug Co. v. Jones*, 367 So.2d 431 (S.Ct. Miss.1978) (druggists).

<sup>5</sup> In *Healthco*, the court expressly agreed with the bankruptcy cases, *supra*, refusing to approve indemnification clauses. 195 B.R. at 987 & n. 64. The court distinguished between bankruptcy approval and judicial enforcement of a prepetition agreement.

<sup>6</sup> *Valhal*, a non-bankruptcy case, illustrates the judicial hesitation to approve the efforts of professionals to immunize themselves from the consequences of their negligence. The court enforced an exculpatory clause, but only because (a) the case involved a matter of private contract with no public interest implicated; (b) the parties were presumed to have equal

Financial advisors who hold themselves out to be professionals, and who are subject to the same standards of scrutiny under §§ 327, 328, and 1103 must be subjected to similar strictures. The degree of learning and skill brought to their task is similar. As with other professional negligence, a financial advisor's mistakes will often engender serious injuries; they can cause serious losses to the estate and even force a liquidation. See, e.g., *In re Merry-Go-Round Enterprises, Inc.*, 244 B.R. 327, 330-31, 333 (Bankr. D. Md. 2000) (accounting firm, retained in chapter 11 case to provide services to the debtor as a “turnaround specialist,” settles negligence, malpractice, fraud and fraudulent concealment suit brought by the estate for \$185 million); *Billing v. Ravin, Greenberg & Zackin, P.A.*, 22 F.3d 1242 (3d Cir. 1994) (professional accused of malpractice for failing to perform a number of duties); *Southmark Corp. v Coopers & Lybrand (In re Southmark Corp.)*, 163 F.3d 925, 928 (5<sup>th</sup> Cir. 1999) (unsuccessful multimillion dollar malpractice action against accountants employed by estate examiner).

In voiding an exculpatory clause drafted by a financial advisor, the court in *Erlich v. First Nat'l Bank of Princeton*, 208 N.J. Super. 264, 288 505 A.2d 220, 233 (N.J. Super. L. 1984), concluded:

Unlike doctors and lawyers, who are self-regulated, investment advisers who hold themselves out to the public as having special knowledge and skill are not self-regulated. This distinction does not justify a holding that they may contractually exculpate themselves from negligent advice. \*\*\*

Accordingly, there is no reason to treat professionals differently under sections 327 or 1103 of the Code. In this case, Chanin should be “entitled to no more \*\*\* protection than that afforded

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bargaining power (architect/developer contract); (c) no fiduciary obligation was involved; and (d) the provision at issue was only a limitation of liability and not a comprehensive indemnification. None of those conditions are present here.

to other professionals employed by the Debtor,” such as attorneys, and therefore it should not be authorized to obtain indemnification in advance . *In re Gillett Holdings, Inc.*, 137 B.R.at 458 . See, also, *In re Mortgage & Realty Trust*, 123 B.R. at 630-31 (case involving applications to employ investment bankers by unsecured creditors’ committee and debtor); *In re Drexel Burnham Lambert Group*, 133 B.R. at 27.

Under Section 330 of the Code, a professional can be compensated only if its services are necessary. Given that professionals provide important services, the bankruptcy system must ensure those “professionals would be especially diligent in making sure that they meet the standard of care for exercising their expertise in their work in the case.” *In re Mortgage & Realty Trust*, 123 B.R. at 631. Since allowing indemnification clauses could tend to encourage professionals to ignore this standard of care, and would impair the ability of their unsecured creditor committee clients to properly represent their constituency, if the professional fails to perform its duties, courts should prohibit indemnification of professionals.

Substantial support for this conclusion is drawn from courts’ refusal to allow securities underwriters to enter into indemnification contracts with their issuer clients. *Eichenholtz v. Brennan*, 52 F.3d 478, 484-86 (3d Cir. 1995) (court refused to uphold an indemnification contract because indemnification is inconsistent with the policies underlying the securities laws even though the provision did not violate any express statutory provision); *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 216 (3d Cir. 2000) (citing *Eichenholtz* with approval). See, also, *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970) (refusing to allow indemnification of an underwriter for reckless misconduct).

In *Eichenholtz*, several defendants settled a securities class action suit. *Eichenholtz*, 52 F.3d at 479-81. As part of the settlement agreement, the district court extinguished provisions in four contracts through which the securities issuer had granted indemnification rights to an underwriter that had not agreed to the class action settlement. *Id.*, 479-81, 484-86. The court of appeals affirmed. Before reaching the contractual question, the Third Circuit rejected the underwriter's argument that the securities laws gave it an implied right of action to obtain indemnification from the issuer. *Id.*, at 483-84. The court refused to find such a right because the securities laws are not primarily drafted to "protect the underwriters, but rather [to] protect investors." *Id.* at 483. The court held that indemnifying underwriters served no valid public purpose because it would be "the underwriters, not the victims, who [would] seek indemnification." *Id.* at 483-84.

The Third Circuit relied upon the same policy considerations in refusing to uphold the underwriter's contractual right to indemnification. *Id.* at 484-86. In four separate agreements, the issuer had contractually agreed to indemnify the underwriter "from any and all loss, liability, claims, damage, and expense arising from any material misstatement, untrue statement, or omission." *Id.* at 484. This included the underwriter's "negligent \*\*\* performance of its duties." *Id.* The court refused to sanction these contracts because they undercut the underwriter's incentive to perform its duties competently. *Id.* at 484-86.

The court noted that "[t]he underlying goal of securities legislation is encouraging diligence and discouraging negligence in securities transactions." *Id.* at 484. It held "[t]hese goals are accomplished by exposing issuers and underwriters to the substantial hazard of liability

for compensatory damages.” *Id.* (internal quotation marks omitted).<sup>7</sup> This is so because “an underwriter indemnification provision \*\*\* would effectively eliminate the underwriter’s incentive to fulfill its” duties. *Id.* at 485. Because “contractual indemnification” “allows an underwriter to shift its entire liability to the issuer,” it impermissibly diminishes an underwriter’s incentive to perform its duties and cannot be upheld. *Id.*

The logic of *Eichenholtz* fully applies to bankruptcy professionals. Like underwriters, bankruptcy professionals are hired to assist their clients in their dealings with third parties who “depend” on the professionals’ work.<sup>8</sup> The “incentive” of bankruptcy professionals to accomplish their important tasks would be just as “effectively eliminated” if they could obtain indemnification as would that of an underwriter.

For these reasons, bankruptcy professionals “may not absolve themselves of such a broad range of potential liability or responsibility for their own actions.” *Gillett*, 137 B.R. at 458. This argument should not be construed to be directed against Chanin, in particular, among professional

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<sup>7</sup> Accord, *Globus*, 418 F.2d at 1288 (citing the “*in terrorem* effect’ of civil liability”). As the *Globus* court noted, prohibiting the indemnification of underwriters:

ensures that an underwriter will not be able to increase the issuer's liability while totally avoiding any injury to himself. In both instances, the proper purpose of the Act is to encourage diligence, investigation and compliance with the requirements of the statute by exposing issuers and underwriters to the substantial hazard of liability for compensatory damages.

*Id.* at 1289.

<sup>8</sup> Indeed, the position of the creditors would render the logic of *Eichenholtz* even more compelling in the bankruptcy context. Unlike the typical public investor, the creditor in a bankruptcy proceeding is not there voluntarily.

financial advisors. Rather, “[s]imply stated, indemnification agreements are inappropriate.”  
*Drexel*, 133 B.R. at 27.

**D. INDEMNIFICATION PROVISIONS ARE ESPECIALLY INAPPROPRIATE IN COURT-SUPERVISED BANKRUPTCY ACTIVITIES.**

As shown above the indemnity, Indemnification Provisions requested by Chanin should be disallowed because of the judicial policies respecting the standards of conduct demanded from professionals. Those Indemnity Provisions should also be voided on the independent basis that Chanin’s provision of services as a professional financial advisor to the committee in a bankruptcy proceeding imbues the firm with special legal and public duties.

“[A] contract for exemption from liability for negligence is void and unenforceable if it is violative of law or contrary to some rule of public policy \*\*\*.” 17A C.J.S. Contracts § 262 at p. 268. Public policy considerations bar such arrangements "in the performance of a legal duty or a duty of public service, or where a public interest is involved or a public duty owed, or, when the duty owed is a private one, where public interest requires the performance thereon." *Id.*, at pp. 270-71. Or, as the court in *Rosenthal v. Bologna*, 211 A.D.2d 436, 437, 620 N.Y.S.2d 376, 377 (N.Y. A.D. 1995) (citation omitted) explained,

\*\*\* Contractual clauses which purport to exculpate a party from liability for his own negligence are disfavored, and invite close judicial scrutiny. Normally, such exculpatory agreements will be upheld in a purely commercial setting, or where voluntary nonessential social activities are freely engaged in by consenting parties. \*\*\*

Needless to say, the services of the financial advisor in this case cannot be described as “nonessential.” If the services are not essential, they should not be sought by the debtors nor approved by the Court – either with or without indemnification provisions. This dispute thus

addresses the reasonable contractual parameters for indispensable, professional services required to maximize the chances for continued fiscal viability.

Nor can it be remotely said that Chanin will be providing its services in a “purely commercial setting.” In a commercial setting, the parties would not be submitting the retention agreement to a federal court for a mandatory, independent review of its reasonableness. This transaction is submitted for sanction in the extremely regulated environment of Chapter 11 reorganization.

Bankruptcy fiduciaries have always been held to particularly high standards of honesty and loyalty. See, generally, *Woods v. City Nat'l Bank & Trust Co.*, 312 U.S. 262, 269 (1941) (trustees and creditor committees); *Mosser v. Darrow*, 341 U.S. 267 (1951) (same). See, also, *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928). As Chief Judge Cardozo explained in *Meinhard*, “[m]any forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties.” *Id.* In the workaday world of solvent companies, it may be appropriate for some companies to bestow indemnity on their professionals. But, in a bankruptcy proceeding, it is improper for a provider of professional services, seeking court approval under § 1103, to seek a blank check that may wind up being drawn on the bank accounts of the creditors it represents.

In the course of enacting the Bankruptcy Reform Act of 1978, the legislators explained:

The practice in bankruptcy is different for several reasons. First, there is a public interest in the proper administration of bankruptcy cases. Bankruptcy is an area where there exists a significant potential for fraud, for self-dealing, and for diversion of funds. In contrast to general civil litigation, where cases affect only two or a few parties at most, bankruptcy cases may affect hundreds of scattered and ill-represented creditors. In general civil litigation, a default by one party is relatively insignificant, and though judges do attempt to protect parties' rights, they need not be active participants in the case for the protection of the public interest in seeing disputes fairly resolved. In bankruptcy cases,

however, active supervision is essential. Bankruptcy affects too many people to allow it to proceed untended by an impartial supervisor.

H.R. Rep. No. 95-595, at 88 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6050 (footnotes omitted). *Cf.*, *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 191-92 (3d Cir. 2000) (requiring district courts to engage in a thorough and independent review of fee requests in common fund cases).

On its appointment, the UCC accepted the mantle of fiduciary, thereby obligating itself to perform its duties in the way that best serves the interests of its constituency. *Woods v. City National Bank & Trust Company*, *supra*. See also *CFTC v. Weintraub*, 471 U.S. 343, 355 (1985) (holding debtors in possession have a fiduciary duty to their creditors); *Official Comm. of Unsecured Creditors of United Healthcare Sys., Inc. v. United Healthcare Sys., Inc. (In re United Healthcare Sys., Inc.)*, 200 F.3d 170, 177 n.9 (3d Cir. 1999), *cert. denied*, 530 U.S. 1204 (2000) (applying *Weintraub* and 11 U.S.C. § 1107(a) to hold “a debtor-in-possession is a fiduciary for its estate and its creditors”).

For this reason, the UCC is required to satisfy itself that it is acting fairly to its constituency before it seeks to bestow indemnification upon Chanin. See *Everett v. Perez (In re Perez)*, 30 F.3d 1209, 1214 (9<sup>th</sup> Cir. 1994) (chapter 11 debtor must satisfy itself that cramdown is proper before so certifying to the court). The UCC in this case has failed to meet that requirement. This is especially apparent since the UCC opposed the indemnification provisions contained in the Debtor’s application to employ Peter J. Solomon Co., Ltd., as its investment banker.

It is important to bear in mind that potential negligence claims against a financial advisor would be property of the estate. 11 U.S.C. § 541(a)(7). See also *Southmark Corp. v. Coopers &*

*Lybrand (In re Southmark Corp.)*, 163 F.3d 925, 928 (5<sup>th</sup> Cir. 1999) (Debtor’s malpractice cause of action against a Chapter 11 examiner’s accountant is a core proceeding). Absent the promise of indemnification, the debtor in possession would have a fiduciary duty to seek recovery, for the benefit of its creditors, from a negligent financial advisor for that loss. See, generally, *Integrated Solutions, Inc. v. Service Support Specialities, Inc.*, 124 F.3d 487, 491 (3d Cir. 1997); *Billing v. Ravin, Greenberg & Zackin, P.A.*, 22 F.3d 1242 (3d Cir.), *cert. denied*, 513 U.S. 999 (1994); *In re Thompson*, 116 B.R. 679, 682 (Bankr. W.D. Ark. 1990), *In re Interwest*, *supra*. Presumably, the UCC could seek court approval to pursue such a cause of action, in the event the Debtor would be reluctant to do so. Inasmuch as estate property may be sold only when an estate’s creditors will benefit, the law imposes a fiduciary duty upon debtors in possession to conserve claims and commands them to take necessary affirmative actions to realize upon such claims for the benefit of their creditors. *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 474 (3d Cir. 1998) (“among the fiduciary obligations of a debtor-in-possession is the ‘duty to protect and conserve property in its possession for the benefit of creditors’”) (quoting in part *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 169 (Bankr. S.D.N.Y. 1990)). See, also, *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 12 (2000) (noting that a trustee - and thus by inference a debtor in possession - must pursue a claim under 11 U.S.C. § 506(c) because “the trustee is obliged to seek recovery under the section whenever his fiduciary duties so require”). Indeed, not only would the debtor in possession "have a strong incentive to pursue" such claims, "but both the trustee and the debtor in possession have a fiduciary duty to pursue viable § 506 claims that would benefit the estate." *Ford Motor Credit Co. v. Reynolds &*

*Reynolds Co. (In re JKK Chevrolet, Inc.)*, 26 F.3d 481, 485 (4<sup>th</sup> Cir. 1994).<sup>9</sup> The UCC in this proceeding, by agreeing to the indemnification provisions sought by Chanin, is failing in this regard. Again, this is glaringly evident since the UCC opposed a similar indemnity provision in relation to the Peter J. Solomon Co., Ltd. employment application.

Bankruptcy does not allow a debtor in possession or a creditors' committee to give up a potentially valuable claim when there is no idea as to what it might be worth. To the contrary, to ensure that estate property is sold only for full value, all sales are conditioned upon "notice, a hearing, and a court determination that the [sale] is in the best interests of the estate." *Northview Motors, Inc. v. Chrysler Motors Corp.*, 186 F.3d 346, 350-51 (3d Cir. 1999) (construing 11 U.S.C. § 363). This is not a case where a creditors' committee attempts to persuade a debtor to sell an asset after it has extensively marketed it, appraised it, and solicited bids. Here, the UCC proposes to give up a right to seek a recovery for its constituency with no notion of what that right might be worth. The indemnification arrangements are thus objectionable not only because they encourage a standard of care that is inconsistent with an investment banker's fiduciary obligations to the creditors; the indemnification provisions are also inconsistent with the fiduciary obligations imposed on UCC by virtue of its appointment.

### **Conclusion**

The United States Trustee respectfully requests that the employment application for Chanin be denied until and unless Chanin provides the additional information requested herein and otherwise complies with the requirements for retention under relevant case law and 11 U.S.C.

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<sup>9</sup> *Cf. Myers v. Martin*, 91 F.3d 389, 394 (3d Cir. 1996) ("it is the trustee's duty to both the debtor and the creditor to realize from the estate all that is possible for distribution among the creditors") (quoting 4 *Collier on Bankruptcy* ¶ 704.01 15th ed. 1993).

§ 1103. Further, the U.S. Trustee respectfully requests that Chanin be required to comply with the provisions of 11 U.S.C. §§ 330 and 331 by providing detailed time records and fee applications subject to review of the parties and approval by the Court in this case as to reasonableness of the fees requested pursuant to 11 U.S.C. § 330. Further, the provisions discussed above which do not comply with Bankruptcy Code requirements or seek to limit the jurisdiction of the Court, should be voided. In particular, the Indemnity Provisions should be voided in their entirety as being inconsistent with the fiduciary obligations of Chanin and the Unsecured Creditors Committee.

Respectfully submitted,

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The undersigned certifies that a true and accurate copy of the foregoing was mailed to the below listed counsel this 9th day of June, 2001.

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